

TEACHERS' RETIREMENT BOARD  
INVESTMENT COMMITTEE

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SUBJECT: Investment Branch Overview

ITEM NUMBER: 4

ATTACHMENT: 1

ACTION: \_\_\_\_\_

DATE OF MEETING: February 5, 2003

INFORMATION: X

PRESENTER(S): Christopher Ailman


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Executive Summary:

One of the Investment Branch objectives for 2002-2003 was to provide an orientation for the new Board members and engage in a review of pension governance. This item completes a portion of the first part of that objective. This cover memo provides a summary of the history of the California State Teachers' Retirement System (CalSTRS). The attached packet provides a detailed overview of the Investment Portfolio and Investment Branch. The CIO will review briefly the attachment at the meeting.

**History of CalSTRS and the Investment Portfolio**

Listed below is a condensed time line of the investment portfolio.

- 
- ❖ The California State Teachers Retirement fund was created on July 1, 1913.
  - ❖ The CalSTRS investment portfolio first crossed \$1 billion of assets in 1966. At that time, in accordance with the State Constitution, the portfolio was comprised entirely of bonds. In addition, the same investment staff jointly managed the portfolios for both CalSTRS and CalPERS.
  - ❖ By 1970, the portfolio had grown to \$1.7 billion and included mortgage loans to gain diversification. Also that year, Proposition 6 passed, allowing CalSTRS to invest up to 25% in equities.
  - ❖ In 1975 the California Legislature reported that CalSTRS had a \$7.8 billion unfunded liability. The System was less than 40% funded.
  - ❖ During the 1980s, assets grew to \$7.2 billion and included a combination of stocks, mortgage loans, but the majority remained in bonds. At that point, CalSTRS was already active in corporate governance. In 1983, the Legislature terminated the interagency investment agreement with CalSTRS for investment management, and CalSTRS contracted for its first Chief Investment Officer, one general consultant and three external investment managers.

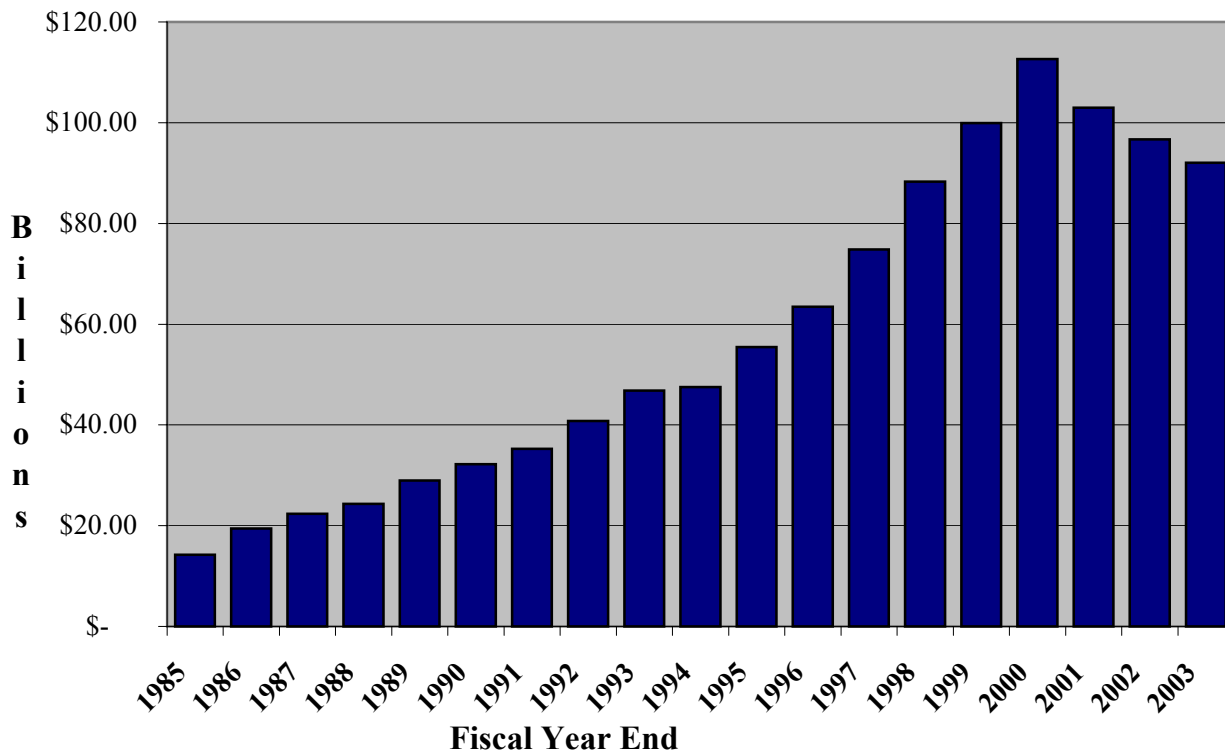
- ❖ In 1984, the people of California passed proposition 12, charging pension boards with the “prudent expert standard”, which resulted in a broad diversification of the investment portfolio. By mid-decade the System was still only 60% funded.
- ❖ In 1984, the Legislature mandated establishment of full time positions to vote proxies and be conversant on corporate governance matters. At the encouragement of the late Jesse Unruh, CalSTRS was among the early founders of the Council of Institutional Investors.
- ❖ By 1990, the portfolio had grown to \$32 billion. The Investment staff exceeded 15 professionals. The portfolio included real estate and private equity. CalSTRS had improved to a 75% funded status.
- ❖ In 1997, the Board hired a new CIO and the assets were shifted to match the actual asset allocation targets just as the bull market of the late 1990’s hits full swing.
- ❖ During the decade of the 90’s, the portfolio benefited from the historic bull market and grew to just under \$100 billion by June 30, 1999. The portfolio expanded to include Non-U.S. equity and broader internal management.
- ❖ By the end of the decade, the System became fully funded for the first time in its history. Coupled with the growth in assets the investment staff also grew to over 42 people. In the fall of 2000, with senior staff departure, the Board hired its third CIO just as the bull market of the 1990’s came to an end.
- ❖ The prolonged bear market of 2000 to present dropped the System’s assets back below \$100 billion and the funded ratio fell to 98%. Despite the worst bear market for stocks since the 73-74 bear market, the investment portfolio fared much better than similar plans in 1974, thanks to its broad diversification and structure.
- ❖ In 2001, the Investment Committee adopted a California Investment Policy. During the year, the Investment Committee allocates funds within private equity and real estate to programs that targeted the underserved portions of California.
- ❖ With the collapse of Enron, WorldCom, and Tyco, the Fund increased its leadership in corporate governance to help restore investor confidence in the financial markets. CalSTRS was, and is, pro-active in effecting change in the Securities and Exchange Commission, the accounting industry, and leading corporations.



## Investment Branch Overview

*"Securing the financial future and sustaining the trust of California's educators"*

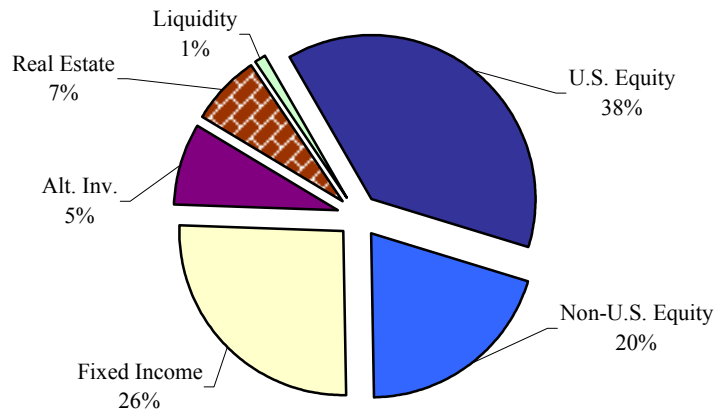
### CalSTRS Asset Growth



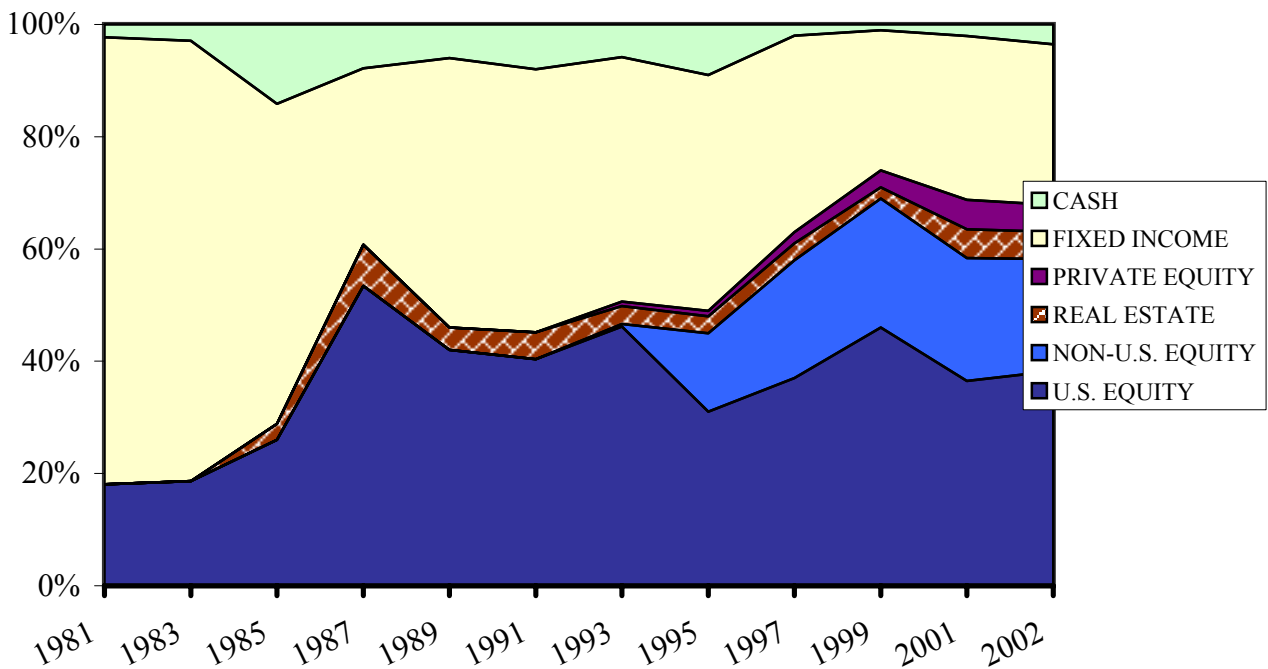
# Asset Allocation

	Current December-02	FY '02-'03 Target	2005 Target
U.S. Equity	38.3%	41%	38%
Non-U.S. Equity	19.9%	20%	20%
Fixed Income	28.6%	26%	26%
Alternative Investments	4.8%	6%	8%
Real Estate	4.9%	6%	7%
Liquidity	3.6%	1%	1%

**Long-term  
target**



## Actual Asset Allocation Mix 1981-2002



# CalSTRS Fast Facts

<b>Assets</b>	As of Nov. 30, 2002	(in thousands)	Percent
Defined Benefit Plan		\$94,344,189	99.1%
Supplemental Defined Benefit plan		\$749,750	0.8%
Cash Balance Plan		\$23,385	0.0%
403(b) Tax Sheltered Annuity		\$64,016	0.1%
<b>TOTAL ASSETS</b>		<b>\$95,181,340</b>	

## Participants

Active & Inactive members	538,367	75%
Retirees, Disability & Survivor Benefits	177,069	25%
<b>TOTAL PARTICIPANTS</b>	<b>715,436</b>	

## Contribution Rates (2002-2003)

State of California*	1.98%
Employer	8.25%
Employee	6.00%
Employee Supplemental Plan	2.00%

\*- Purchasing Power Protection

- The State provides 2.5 percent of the prior calendar year member creditable earnings to fund purchasing power protection, currently set at 75 percent.

Funded Ratio	92%
(Actuarial Assets as a % of Actuarial Accrued Liability)	

CalSTRS Operating Budget (in thousands)	\$78,852
Personnel	566

## Executive Director & Senior Investment Staff

Jack Ehnes, Executive Director

Christopher Ailman, Chief Investment Officer

Elleen Y. Okada  
Director Investment Administration  
and External Relations

Steven Tong  
Director of Internal Equities

Réal Desrochers  
Director of Alternative Investments

Michelle Cunningham  
Director of Fixed Income

Michael T. DiRé  
Director of Real Estate

***CalSTRS is the 3rd largest pension plan in the U.S.A.***

# CalSTRS Investment Branch

## Investment Philosophy & Objective:

**To buy long-term net cash flows at a reasonable price.**

The Investment return objective is to achieve a relative return in excess of the index return of our strategic asset allocation, achieve a return 3.5% higher than inflation, and achieve an absolute return in excess of the actuarial assumed return of 8% over a three year period and finally a return that meets the liabilities of the plan.

## Management Philosophy

We are one of the top investment management companies in the world. We strive to work cohesively with the Investment Committee to exceed our common goals. We are policy driven to ensure there is clear communication, coordination, and compliance to the Board objectives. We plan our work and work our plan to ensure efficient and effective coordination in the management of the portfolio.

## Key Values within the Branch

~ Respect      ~ Personal Development      ~ Balance  
~ Worth      ~ Challenge      ~ Purpose

The Investment Branch is managed as a friendly collegial environment, where honesty, integrity, and the desire to be "best in class" are the cornerstone of our work. The most important assets at CalSTRS, walk in and out of the office doors everyday!

# Senior Investment Staff

**Christopher J Ailman** is Chief Investment Officer of the California State Teachers' Retirement System, the third largest U.S. pension fund in the nation. Mr. Ailman leads a team of five directors, and a support staff of 62. He joined CalSTRS in the fall of 2000. Mr. Ailman has over 20 years of investment management experience. Prior to joining CalSTRS Mr. Ailman served for four years as the CIO for the \$60 billion Washington State Investment Board. In the year 2000, he received the Robert Toigo award from the Institute for Fiduciary Education as the CIO of the year. Prior he served as the CIO for the Sacramento County Employees Retirement System and the County of Sacramento Treasurer. Prior to his positions in the public sector, Mr. Ailman worked five years in the private sector as an investment consultant and financial planner. Mr. Ailman has a Bachelor of Arts in Business Economics from the University of California Santa Barbara in 1980. He received his Certified Financial Planner from the University of Southern California in 1984.

**Elleen Y. Okada** is the Director Investment Administration and External Relations. She has been with the CalSTRS, for over 25 years. Her current responsibilities encompass Investment Administration, External Managers, Corporate Governance and Operations. In her career at CalSTRS she has started in investment accounting, she established the investment operations unit, and has served as Deputy CEO – Investments. She also serves as a member of the Executive Staff of CalSTRS.

**Steven Tong** is the Director of Internal Equities. At CalSTRS, Mr. Tong is responsible for research, development and implementation of internal equity investment strategies and manages about \$13 billion domestic equity assets. He has 17 years of investment experience with CalSTRS. Mr. Tong holds a B.S. degree in Business Administration with a specialty in accounting from the California State University, Sacramento.

**Michelle Cunningham** is the Director of Fixed Income. The Fixed Income unit is an internally managed portfolio of \$28 billion. Ms. Cunningham has specific responsibility for the daily management and oversight of a bond portfolio that includes Corporate, Treasury, Agency, Mortgage-Backed Securities and the System's cash. She has been with CalSTRS for over 11 years. Prior to joining CalSTRS, Ms. Cunningham had more than six years experience at the City of Sacramento Treasurer's Office, where she managed the investment strategies for both the City's General Fund Portfolio and Retirement Fund Portfolio. Ms. Cunningham holds a B.S. degree in Business/Finance from California State University, Sacramento, and a Masters of Business Administration in Finance from the California State University, Sacramento. She is also an active member of the Association for Investment Management and Research (AIMR) and has the designation of Chartered Financial Analyst (CFA).

**Réal Desrochers** is the Director of Alternative Investments. He joined CalSTRS in 1998. Prior to CalSTRS, he accumulated more than 11 years of international private investment experience with Caisse de Depot, Canada's largest pension plan. He was responsible for the management of an international private equity portfolio investing in the U.S., Europe, Asia and Latin America. Previously, he held several senior executive positions with the Canadian Renewal Board. He has a diploma in food technology, a B.A. in Business and MBA from Laval University in Quebec, and attended senior executive seminars at the INSEAD in France and Wharton University in Kyoto, Japan. Mr. Desrochers' professional affiliation includes A.I.M.R. He is also a Fellow member of the Royal Society of Arts in London. He is fluent in French and English and has a good knowledge of Spanish.

**Michael T. DiRé** is the Director of Real Estate. Mr. DiRé leads a real estate portfolio of approximately \$5 billion, including both discretionary and non-discretionary investment. He joined CalSTRS in July of 2000. Prior to joining CalSTRS, he was a Real Estate Investment Specialist for the California Public Employees Retirement System (CalPERS). Mr. DiRé's primary responsibilities included management of CalPERS retail real estate portfolio valued at approximately \$2 billion, CalPERS indexed REIT fund and the California Urban Investment Partners (CUIP). Prior to joining CalPERS, Mr. DiRé worked for Deloitte and Touche Real Estate Consulting Group, and Liquidity Fund Financial Corporation. He holds a Bachelor's degree in Real Estate and Finance from California State University of Sacramento and is a member of NAREIT and ICSC.

# U.S. Equity

**TOTAL ASSETS :** \$ 35,232,430,125

**BENCHMARK:** Russell 3000 ex-Tobacco Index

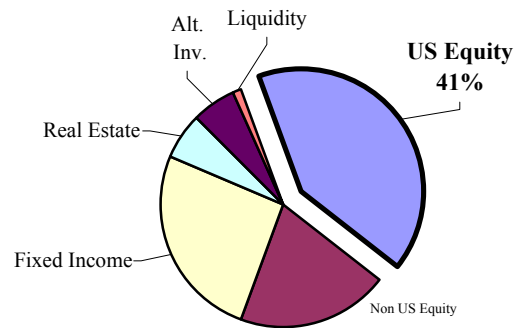
## PROGRAM:

### External Equity

- Manager Monitoring, both Active, Passive, Internal, and External Managers
- Directed Brokerage (Soft Dollar) Management
- Corporate Governance & Proxy Voting

### Internal Equity

- Russell 1000 ex-Tobacco Indexed Portfolio
- Cash Equitization Program
- Post Venture Capital Distribution Liquidation Service

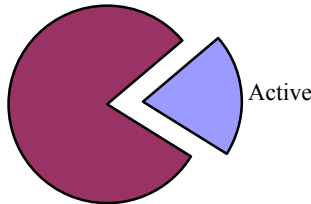


## ASSET CLASS STRUCTURE:

Externally Managed (63%)

Internally Managed (37%)

Passive



20% Active Management

80% Passive Management

## STAFFING:

### External Equity

Elleen Okada, Director  
 Janice Hester Amey, Principal Investment Officer<sup>d</sup>  
 Trish Taniguchi, Investment Officer III  
 Glenn Ida, Investment Officer II  
 Andy Iseri CFA, Investment Officer II  
 Richard Kwong, Investment Officer I\*  
 Eric Kwong, Investment Officer I  
 Ted Nishio, Investment Officer I\*  
 Tiffany Vispetto, Associate Investment Officer\*  
 Vacant, Assistant Investment Officer\*

### Internal Equity

Steven Tong, Director  
 Deborah Contini, CFA, Investment Officer III  
 Vacant, Investment Officer I  
 Stacy Hussey, Associate Investment Officer  
 Nancy Flora, Office Technician

Carmen Lopez, Office Technician

\* - Corporate Governance team

## EXTERNAL MANAGERS:

Ariel Capital Mgt. Active Managers  
 BarclaysGlobal Investors  
 Brown Capital Mgt.  
 Chicago Equity Partners  
 Delaware Investment Advisors  
 Delphi Management  
 Denver Investment Advisors  
 DSI International Mgt.  
 First Quadrant  
 Mellon Capital Mgt.

NCM Capital Mgt. Group  
 Putnam Investments  
 Sasco Capital Mgt.  
 State Street Global Advisors  
 TCW Asset Mgt.  
 UBS Asset Management

### Passive Managers

Barclays Global Investors  
 TCW Asset Mgt.



# Non-U.S. Equity

**TOTAL ASSETS :** \$ 18,360,097,463

**BENCHMARK:** MSCI ACWI ex US & Tobacco  
(All Country World Index ex. U.S.)

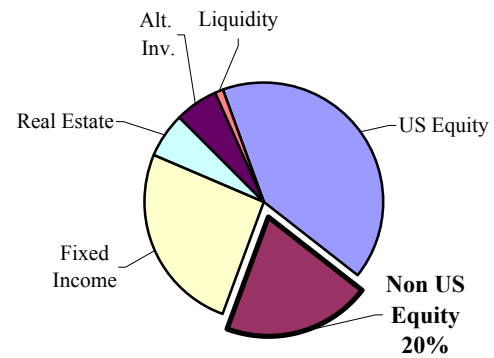
## PROGRAM:

Developed Markets

- Passive EAFE Managers
- Active EAFE Managers
- Active European Region Managers
- Active Pacific Region Managers

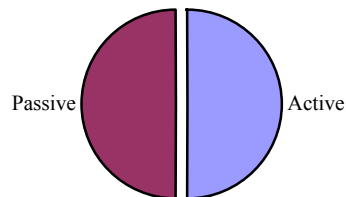
Emerging Markets

- Active / Passive Index Manager



## ASSET CLASS STRUCTURE:

100% Externally Managed



50% Active Management

50% Passive Management

## STAFFING:

### External Equity

Elleen Okada, Director  
Janice Hester Amey, Principal Investment Officer  
Trish Taniguchi, Investment Officer III  
Glenn Ida, Investment Officer II  
Andy Iseri CFA, Investment Officer II  
Eric Kwong, Investment Officer I  
Carmen Lopez, Office Technician

### Corporate Governance

Janice Hester Amey, PIO  
Richard Kwong, Investment Officer I  
Ted Nishio, Investment Officer I  
Tiffany Vispetto, Assoc. Invest. Officer  
Vacant, Assistant Investment Officer

## EXTERNAL MANAGERS:

Capital Guardian Trust Company  
Lazard Freres Asset Mgt.  
Morgan Stanley Asset Mgt.  
Delaware International Adv.  
Fiduciary Trust Asset Mgt.  
Nicholas Applegate Capital  
Oechsle International Adv.  
Newport Pacific Mgt.  
Schroder Capital Mgt.  
BlackRock, Inc.

## Active Managers

Bank of Ireland Asset Mgt.  
Marvin & Palmer Assoc. Inc.  
Battery March Financial Mgt.  
UBS Asset Management  
Goldman Sachs Asset Mgt.  
Fidelity Management Co.

### Passive managers

State Street Global Advisors  
Barclays Global Investors

# Fixed Income

**TOTAL ASSETS :** \$ 29,584,782,351

**BENCHMARK:** Lehman Aggregate plus the  
High Yield Cash Pay (ex tobacco)

## PROGRAM:

Core Fixed Income Portfolio

- Governments & Agencies
- Credit / Corporate bonds
- Securitized Assets (MBS, ABS, CMBS)
- High Yield Bonds (Externally managed)

Cash Management

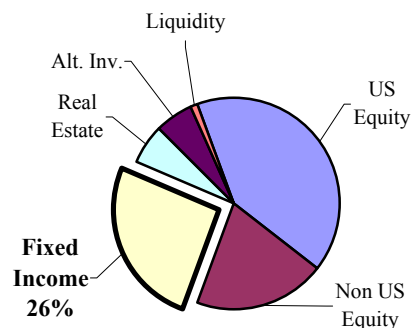
- System Cash
- Securities Lending Cash

Currency Hedging

- Hedge the passive Non-US Equity portfolio

Home Loan Program

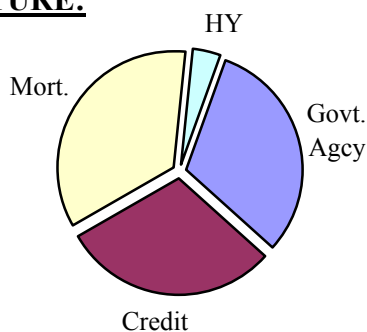
Securities Lending Program



## ASSET CLASS STRUCTURE:

96% Internally Managed

4% Externally Managed



31% Governments & Agencies  
30% Credit / Corp. Bonds  
35% Securitized Assets (Mort.)  
4% High Yield Bonds

## STAFFING:

Michelle Cunningham CFA, Director

Paul Shantic, Principal Investment Officer (Credit)

Glenn Hosokawa CFA, Principal Investment Officer (Govt. & Currency Trading)

Carol Merlini, Investment Officer II (Mortgage Backed & CMBS)

John Perez, Investment Officer II (Cash Management & ABS)

John Dillie, Investment Officer I (Credit)

Michael Yager, Investment Officer I (Credit)

Robert Woods, Investment Officer II (Home Loan Program)

Joe DeLuca, Investment Officer I (Home Loan Program)

Stacey Reichenberg, Investment Officer I (Cash Management)

David Judnick, Investment Officer I (Mortgaged Backed)

Vacant, Investment Officer I (Credit)

Rosie Lucchesini-Jack, Associate Investment Officer (Govt.)

Dan Depner, Assistant Investment Officer (Currency)

Laurie Masters, Office Technician

# Real Estate

**TOTAL ASSETS :** \$ 4,482,517,398

**BENCHMARK:** NCREIF

## PROGRAM:

### **Real Estate**

#### **-- Low Risk - Core Portfolio**

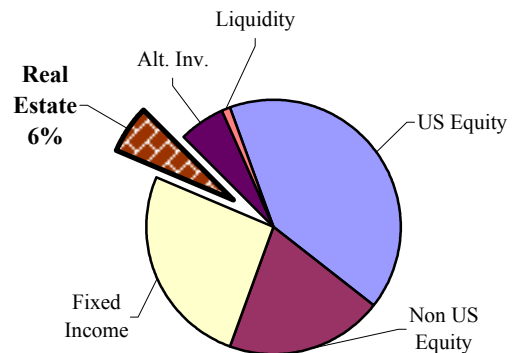
-- Primarily Low Leveraged Office, Apartment, Industrial and Retail Assets

#### **-- Moderate Risk - Value Added Portfolio**

-- Includes Development, Lease Up and Moderately Leveraged Assets

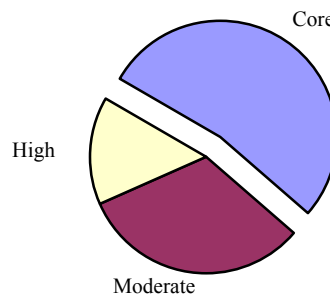
#### **-- High Risk - Opportunistic Portfolio**

-- Includes Opportunity Funds and Development, Redevelopment, Urban and Highly Leveraged Assets



## ASSET CLASS STRUCTURE:

100% Externally Managed



53% Low  
32% Moderate  
15% High

## STAFFING:

### Real Estate

Mike DiRé, Director

Jim Hurley, Investment Officer III (Apartment)

Mike Thompson, Investment Officer III (Office)

Hank Thomas, Investment Officer II (Industrial)

Greg Nyland, Investment Officer II (Retail)

Vacant, Investment Officer II

Laura Caravello, Investment Officer I

Vacant, Associate Investment Officer

Michele Higginbotham, Office Technician

## CONSULTANT and INDEPENDENT FIDUCIARIES:

Consultant - Pension Consulting Alliance (PCA)

Independent Fiduciaries - Eleven (11) firms including PCA

## MANAGERS AND JOINT VENTURE PARTNERS:

AIMCO

Beacon

Canyon-Johnson

CB Richard Ellis

CIM Urban

Clarion

Colony Capital

Fairfield

Fortress

Heitman Capital

Lazard Freres

Lend Lease

Lone Star

Lowe Enterprises

Morgan Stanley

Principal RE Investors

Sentinel

SF Waterfront

Simon & Sons

Soros

SSR Realty

Thomas Properties

Waterton

# Alternative Investments

**TOTAL ASSETS :** \$ 4,405,920,224

**BENCHMARK:** STRS Custom Benchmark  
Russell 3000 Index plus 500 bp.  
and 90 Day T-bills

## PROGRAM:

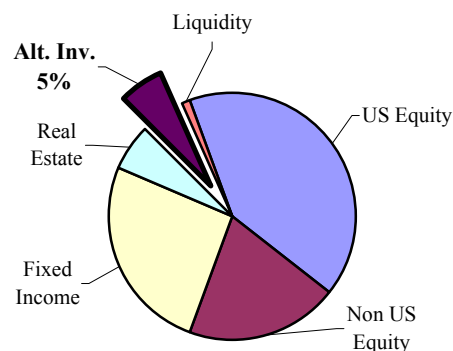
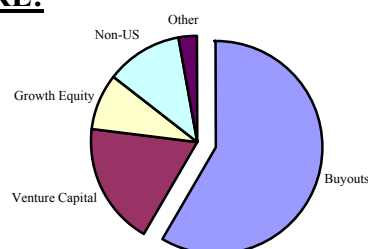
Private Equity

- Limited Partnerships
- Secondary Interests in Limited Partnerships
- Co-investments

Credit Enhancement

- Letters of Credit
- Liquidity Agreements

## ASSET CLASS STRUCTURE:



## STAFFING:

Real Desrochers, Director  
 Richard Rose CFA, Principal Investment Officer  
 Seth Hall, Investment Officer II  
 Deanna Winter, Investment Officer II  
 Margot Wirth, Investment Officer II  
 Jean Kushida Uda, Investment Officer II (Credit Enhancement)  
 Vacant Investment Officer II  
 Vacant Investment Officer II  
 Delfina Palomo, Investment Officer I  
 Kay Leen Bartlett, Assistant Investment Officer  
 Wendy Hughey, Office Assistant

## CONSULTANT / ADVISOR:

McKinsey Associates - Board Consultant  
 KPMG LLP - Independent Fiduciary  
 Pacific Corp. Group. - Independent Fiduciary

Altius Associates Limited - Gatekeeper Europe  
 Houlihan Lokey Inc.- Independent Fiduciary  
 S&P Value Advisors- Independent Fiduciaries

## MAJOR GENERAL PARTNERSHIP RELATIONSHIPS

New Enterprise Associates (NEA)  
 Summit Ventures  
 InterWest Partners  
 TA

Whitney  
 VantagePoint  
 Navis Partners

Welsh, Carson, Anderson, & Stowe  
 Blackstone  
 Madison Dearborn Partners  
 Texas Pacific Group

# Investment Operations

**TOTAL ASSETS :** \$ 92,065,747,561

## **PROGRAM:**

Trade Settlement

- Cash and Security Settlement
- Movement of Funds
- Unitizations for the CB and DBS programs

Portfolio Accounting

- Internal Investment Portfolio Accounting

Branch Management of Information Technology

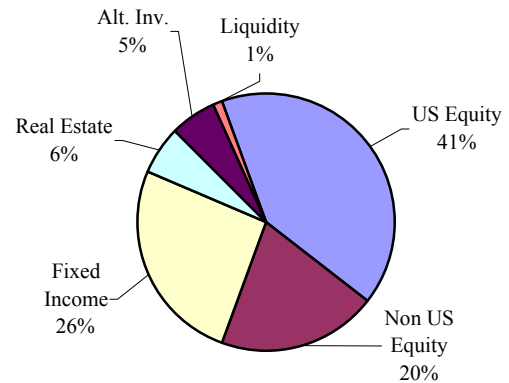
## **STAFFING:**

### Operations

Elleen Okada, Director  
John Petzold, Principal Investment Officer  
Margaret Morris, Investment Officer III  
Debra Smith, Investment Officer II  
Kimberly Yamamoto, Investment Officer I  
Janet Scott, Investment Officer I  
Curtis Takechi, Investment Officer I  
Krista Jackson-Ingram, Associate Investment Officer  
Connie Tyer, Assistant Investment Officer  
Marlene Noss, Assistant Investment Officer  
Mary Ann Avansino, Administrative Assistant I  
Vacant, Associate Investment Officer

## **CRITICAL BUSINESS RELATIONSHIPS:**

State Controller's Office  
State Street Bank, Alameda & Boston - Custodian  
Thomson Financial  
Factiva News Service  
Frank Russell  
Standard & Poors'  
BARRA  
Interactive Data Corp.  
Vestek



State Treasurer's Office  
Depository Trust Comp. DTC  
Bloomberg Financial Services  
Bridge Financial Services  
Morgan Stanley Capital International  
Moody's Rating Service  
Elkins McSherry  
ProxyEdge, IRRC, and ISS  
Bank One